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AUSTIN H. CARR, Editor, 10 Adelaide Street East, Toronto

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Editorial Comment

The Season's Greetings

December is the month of Christmas. We take this opportunity of extending on behalf of our President and the Council of our Association the season's greetings to all mem-

bers and readers.

There will doubtless be some hesitation this year about expressing the old familiar wish of "Merry Christmas," especially to kindred and friends in the Old Country where the shadow of death and destruction lies menacingly across the land. War, the unwelcome visitor of all ages, has again placed its heavy burden upon the hearts and homes of thousands. At this time more than at any other festive season of the year, we might well question whether the world is growing better or worse. "I am a part of all that I have met," was the significant observation of Ulysses who on his own testimony had "enjoyed greatly" and "suffered greatly." Though nations at present are equipped with more deadly weapons and fiendish devices for the destruction of human life and property than at any prevous time, this nevertheless must all be regarded merely as a passing phase in the long development of mankind towards an ideal. There is no question but that

human progress in the main has been upward; there is plenty of evidence that in man there abides much of the best that the race has met. No better indication of the dawn of the universal brotherhood of man and of the day when men shall dwell together in unity is needed than the genuine sympathy expressed by millions of people throughout the world over the brutality and the indignities recently visited upon the inhabitants of Czechoslovakia and Poland, who in every way are men and women and children like as we are. Though the events of the year 1939 are out of keeping with the history and the memories that surround Christmas Day, we nevertheless are able to cherish fond recollections of the past, to look forward with hope to the future and to commemorate this month the birth nearly two thousand years ago of the Prince of Peace. To all our members and readers, then, a joyful Christmas!

The War and The Profession Members of the profession who are familiar with some of the experiences of the Great War will realize that there is perhaps no activity of greater importance in

the national economy at this time than accounting. Speaking as it does for the profession in Great Britain, The Accountant gives as its opinion that "accountants will be called upon for the most solid contribution to the maintenance of the economic front and the support of the fighting forces." In elaborating upon that contribution it points out that help will be needed first in providing the government with the amplified revenue which will be necessary, second in helping the supply services to obtain their requirements in the most economical fashion, and third in aiding private business units to carry on in the new circumstances which may be thrust upon them. This applies equally well in Canada, but to all this should be added the large opportunities of service for chartered accountants with the Federal government in its institution of war-time regulations in industry and finance. No matter how clearly expressed regulations may be, they will nevertheless be open to many genuine errors of construction as well as subjected to all conceivable forms of transgression and evasion, and will tend to lose much of their effectiveness unless placed under the check of those capable of seeing that their spirit as well as their letter is duly respected.

Contracts For War Supplies When this country last September declared itself in a state of war against that great enemy of mankind in Europe, the government realized that such unusual

times required exceptional measures, and in consequence a special session of Parliament was called to enact emergency legislation. One of the Acts passed was The Department of Munitions and Supply Act, the purpose of which was to establish a department of munitions and supply with authority to mobilize the resources of our nation for the production of essential materials towards the successful prosecution of the war. The Act also provided for a control over the making of contracts in connection with the expenditures to be incurred in such production. Consequently authority was given to the Minister of Munitions and Supply to direct any person making munitions of war or supplies to produce any books or documents required by the Minister, and should he find such records to be "insufficient to enable a fair and reasonable price to be determined . . . he may direct that person to keep such records as may be specified."

It has been said that the Dominion government and the governments of our allies feel themselves much wiser after the experiences of the war of a quarter century ago. They at least have had plenty of object lessons. One of the aims of these governments is that a large degree of efficiency be attained in the department of the public treasury so that the tremendous expenditures necessary for the successful prosecution of this war may be made wisely and with a single eye for the taxpayer who is the one to foot the bill. Every precaution, it seems, is to be taken against the possibility of any individual or firm making abnormal profits such as were realized by some companies and industries during the last war.

Under the powers conferred by this Act, the government has lost no time in organizing a War Supply Board to operate until the Ministry of Supply is established, and has secured the services not only of the head of one of the biggest industrial organizations in Canada as chairman of the Board but also of technical advisers of acknowledged ability. Such men, animated by a keen sense of national

responsibility, are devoting their energies to our country during this time of emergency.

Profits on War Contracts

The task of those charged with the responsibility of making purchases for the government is not going to be easy. Nor will the burden of that responsibility be

less heavy to bear if they receive gratuitous suggestions on matters about which the average citizen cannot be expected to have technical knowledge. The advice thus offered at times is little short of amazing. What reply would satisfy a taxpayer who contends, for instance, that war contracts should be awarded on a no-profit basis, or in any case on a basis of cost plus a profit not exceeding, say, five per cent? This suggestion has been advanced publicly more than once both in this country and elsewhere, and according to The Accountant references have been made to it in Great Britain within the past year. One industrialist there, for instance, with undoubted patriotism, announced that he was prepared to manufacture munitions for the government on a "no-profit" basis. Here was a business man actually engaged in manufacturing who was using a term the meaning and application of which he had not seriously considered. Because accounting is not an exact science and because the estimates of productive costs can vary widely, the members of our profession will appreciate the incongruity of an offer of this sort.

During a national situation such as we find ourselves in at present, the events of the day naturally prompt sundry expressions of patriotism. One of these frequently heard is that no one should make a profit out of the war. So there has arisen the term "no-profit" contract. It is one that appeals to the public imagination as highly commendable and worthy of consideration by any manufacturer who wants to demonstrate his patriotism. But is a noprofit contract supposed to mean that one filling war orders for the government must be neither better nor worse off than if he had not entered upon such an engagement? The expression "no profit" needs some scrutiny. The placing of a government order might have one of a number of effects on a company and its plant, and the following three situations are merely offered as illustrations. A plant formerly standing idle would now become active; one running at low capacity but desiring to continue filling its general orders would have an increased output; and one engaged in supplying a lucrative trade built up over a long period, but in a strategic location from the standpoint of the government, decides to devote all its energies to filling war contracts and so is obliged to discontinue supplying the trade.

Problems

To indicate to the reader only a few of Cost Accounting the problems that would present themselves to those called upon to determine the price to be charged the government

on a "no-profit" contract under these conditions, let him attempt to answer any of the following questions. respect of the first plant, if there is no prospect of its becoming otherwise engaged, what charge should be included in costs of production to provide for depreciation of fixed assets? What about interest on bonds, insurance on plant and such other overhead expenses as would be payable if the plant were idle?

When output is thus increased in the case of the second plant, a wider spread of overhead charges is made possible and a greater profit on the sale of general products would result. What course should be followed in regard to such improvements in the firm's condition? What would constitute a fair and reasonable basis in apportioning costs where there were joint operations? If additional plant be needed for filling government orders what annual allowance should be made for depreciation on such addition, particularly if it is acknowledged that this part of the plant will be useless at the close of the war, whenever that may be.

In the third case, if there are preferred shareholders should their dividends be regarded as an expense? What consideration should be given to the protest of a large number of minority shareholders whose only source of income for years has been the regular dividends paid on the company's common shares? Anyway, if the company is to be no worse off after filling government orders, should not its normal profits now being lost be included in costs? Also what provision should be made for the possible loss of the company's goodwill built up over the years by an extensive campaign of advertising?

Problems not greatly different from these will suggest themselves also in the case of "cost plus" contracts.* Those who imagine that the ascertainment of a set margin of profit or of "no profit" is only a matter of simple calculations have much to learn. The accountant in public practice, then, cannot over-emphasize the importance of viewing the subject in its proper perspective by those interested in it. One of the major problems confronting any country at war is that of directing part of the productive capacities of its economy to the supply and manufacture of specialized materials of war. New plants must be built and old ones converted to turning out these necessaries. Is it reasonable to suppose that capital will flow to these new industries or that investments will be diverted from old industries on patriotic grounds alone? We are living in a capitalistic economy and the profit motive is still the driving force behind present-day economic activity. It must be kept in mind that a war industry differs from any ordinary enterprise in that the demand for the products of the former terminates immediately upon the signing of an armistice while the demand for the products of the latter goes on indefinitely. This means that capital will not be sunk in specialized machinery and plant unless there is some assurance of getting that capital out again before the specialized instruments are rendered useless by the cessation of hostilities.

^{*}The Parliament of Canada on 6th April 1939 passed "An Act to establish a Defence Purchasing Board to control the awarding of contracts for the manufacture of defence equipment and the construction of defence projects, to limit costs and control profits in respect of such contracts, and to authorize the raising by way of loans of certain sums of money for such purposes." One section of this Act, in part, reads as follows: "The maximum net profit received by any person in respect of any contract to which this section applies shall be limited to an amount equal to five per centum per annum on the average amount of capital of such person employed in the performance of the contract . . . The net profit of a person in respect of a contract shall be the aggregate amount received by such person under the contract, less such actual expenses and disbursements, allowances for depreciation and overhead charges as shall be determined by the Board to be properly chargeable to the contract, but no interest on borrowed capital shall be deducted. In the determination of net profit, the Board shall apply the principles and practices as to accounting and otherwise governing the determination of taxable income under the Income War Tax Act.'

The difficulties of the public accountant certifying Taxable to contract costs are therefore evident. In stating his position in this respect he may expect, of Profits course, to be met with the question as to how he can ever attempt to prepare or check the government returns of taxable profits of the corporations of which he is the auditor. An entirely different situation exists here. Every nation has its income tax statutes in which highly technical rules are set out for computing profits subject to taxation. These will vary from country to country and even in the various provinces and states of a country, and the profits computed under such legislative provisions may, moreover, vary to a greater or less degree from those computed by the practising accountant. But the rules for determining taxable income as set out in these statutes are arbitrary, and in preparing or checking the income tax returns of his client the auditor must satisfy himself that the accounts are in conformity with those rules. He is not being asked to do something beyond his competence. It is of interest to note that in this regard he will have an additional function to perform when, beginning in 1940, he will be called upon to prepare or to check the returns of profits for companies - including those firms engaged upon war contracts - in accordance with the provisions of The Excess Profits Tax Act which the Government also passed at the emergency session of Parliament last September.

Peter Birtwistle Trust Case

As this issue was going to press, we learned that the Judicial Committee of the Privy Council had allowed the appeal of the Minister of National Revenue from the judgment of the Supreme Court of Canada in the *Peter Birtwistle Trust* case.

WORKMEN'S COMPENSATION LEGISLATION AND ITS ADMINISTRATION IN CANADA

By F. C. Swallow, Chartered Accountant Vancouver, British Columbia

WHEN it is realized that volumes have been written on workmen's compensation and its problems, it will be readily understood that the scope of the subject is much too great to be dealt with completely in an article of this size. An endeavour will be made, however, to give as comprehensive a view of workmen's compensation as the limited space will allow, omitting as far as possible technical and tedious details and stressing what is of greatest interest to employers and workmen.

The original purpose of compensation laws was to compensate the workman for lost time in the case of injury to the extent that his earnings had been reduced by reason of such injury, and in the event of death by accident during the course of his employment, to make provision for his widow and other dependents, if any. From this simple beginning we now have a series of complicated Acts throughout the various provinces which amongst other things provide:

- 1. Protection to the employer against lawsuits brought by workmen for accidents suffered in course of employment.
- 2. For the levying of a premium (or assessment) on the employer in accordance with the common risk of the industry; and by a system of experience rating, the adjusting of the premium so charged in accordance with his individual record.
- 3. For the adoption of safe practices by employers and workmen and the proper guarding of machinery by employers.
- 4. For the workmen in case of accidents in industry, the services of competent medical practitioners and specialists where necessary, nursing services, artificial appliances, hospitalization and transportation.

The various Acts in the different provinces are administered by Boards usually consisting of three members who, in turn, employ accountants, lawyers, doctors, chemists, engineers and other skilled technicians in addition to the

general clerical staff. The duties of the Boards are numerous and their responsibilities heavy; they function in a dual capacity—as a semi-judicial body and as a board of trustees.

In their capacity as a semi-judicial body, the commissioners or their deputies adjudicate on all claims for compensation and hold hearings at which the claimant and his representative may appear. They decide (and from this decision there is no appeal save to themselves) upon the authenticity and legality of the thousands of claims submitted to them. In their capacity as trustees, the commissioners are responsible for the successful administration of the accident fund, which is, in most cases, under their sole control.

When it is understood that the Canadian compensation boards expend annually over \$20,000,000 on compensation and take care of some 200,000 to 225,000 accidents yearly and that their pension funds amount to approximately \$90,000,000, it will be seen that the task of administering so large an undertaking requires a staff of experts whose knowledge has been acquired only after a thorough study of the subject. Common problems are discussed by the various boards, both in Canada and the United States, who endeavour to convene for this purpose as frequently as possible. Representatives call upon the boards of neighbouring provinces or states and co-operation is general. This inter-provincial co-operation is invaluable. mentally accidents are types and, whether they occur in an isolated logging camp or fishing station or in a crowded manufacturing centre, all present certain aspects which are similar. In the same way, administration problems are mutual and the experience of one board benefits the other.

Reciprocal arrangements between provinces obviates double assessment, otherwise it would be necessary for employers having operations extending into two or more provinces, with transfers of workmen from one province to another, to pay double assessment on these workmen. Most Provincial Acts permit the workman, under certain circumstances, to elect in which province he will prefer his claim.

It has been said that workmen's compensation as administered in Canada presents one of the truly socialistic

experiments of the day. In no other country have the boards such complete power, and it speaks well for their administration that such a condition has existed without abuse for almost a quarter of a century.

The administrative staff is usually sub-divided into the following or similar divisions:

- 1. Claims division including medical section
- 2. Assessment division including auditing section
- 3. Accounting, actuarial and statistical division
- 4. Accident prevention and first aid division.

Claims Division—As its name implies, the claims division is responsible for the collection and segregation of all data in connection with claims resulting from accidents. It is sub-divided into four sections: (a) assembly, (b) filing, (c) adjustment, (d) medical.

The various forms in connection with a claim are indexed on receipt and classified in the assembly. The claim must be then passed by the medical section, the claims agent, and if necessary by the legal department and the Board. It next goes to the adjuster who calculates the compensation. The claim file then passes briefly into the accounting division where a cheque is prepared and mailed to the workman. After accounting entries are made, the file is returned to the claims division and is retained in the filing section until again required.

The medical costs are dealt with in the same way. The various hospital and medical charges are paid by the accounting department after being approved by the medical division. The first call on the administration is for prompt payment of compensation to workmen, so speed is essential. The average non-contentious claim is usually paid within forty-eight hours of its completion. Medical and hospital charges are paid monthly or bi-monthly.

Assessment Division—The chief duties of this division are the levying of rates upon the various employers. This entails a tremendous amount of detail work and necessitates the keeping of a mass of files and an up-to-date index of all employers in which changes must be recorded daily. In the older and more settled provinces changes are not so frequent, but in the western provinces small operations are sometimes started and completed before the Board is aware

of their existence. In some cases the locations are so inaccessible that it is necessary for inspectors to travel by air to inspect the operations. Again, as in the case of fishing and placer mining, the industry is seasonal and extreme care must be taken to see that assessments are levied while operations are in progress.

During the year following the levying of the assessment, the auditors attached to this division make audits of employers' payrolls so that the provisional assessment levied may be adjusted in accordance with the actual payroll. Assessments in most provinces are based on payrolls though occasionally a certain industry may be assessed on production or the number of hours worked. In accordance with the law some provinces levy a special assessment known as 'medical aid' to cover medical care, and others include in the general assessment medical attention and compensation.

Accounting, Statistical and Actuarial Division — Upon this division rests the responsibility of the correct keeping of the accounting and statistical records, the collection and disbursement of funds, the making of rates, the investment of funds, etc. It is generally divided into the following sections:

- 1. Cashiers
- 2. Accounting
- 3. Collecting
- 4. Statistical
- 5. Actuarial.

Assessment duplicates are received from the assessment division and are posted to employers' ledger cards; similarly collections from the cashier are duly credited. Overdue accounts are passed to the collection department for action and penalties prescribed by law added and charged to the employer.

The Boards have not hesitated to adopt up-to-date methods to increase the speed and efficiency of their work. Mechanized bookkeeping and statistical systems are common to most of them and cheques are issued and signed mechanically.

The biggest problem from an accounting point of view, however, is the correct allocation to its particular year of that year's costs and collections. Estimating the probable cost of "unfinalled" claims and claims not yet submitted is

not a simple matter. The duration of temporary disability is subject to great uncertainty and the accuracy of the estimated cost of "unfinalled" claims depends on the judgment of individuals and on the medical evidence available. Experience shows such individual estimates to be subject to great fluctuations. There is no known yard-stick to measure the extent of probable future disablements. On record are many cases in which careful examinations by medical officials and specialists indicated no permanent disability, while developments months or years later disclosed permanent disablement and increased the cost in some individual claims by thousands of dollars. Most boards employ their medical staff to value their outstanding claims. To this evaluation they add the sum they consider will take care of claims not yet presented and as yet unknown to them. Experience shows that not more than half of the actual compensation payable is known in the year of the occurrence of the accident.

In the same way as assessments on employers are in the main based on payrolls, of which only estimates are available at the time the assessments are made, it will be seen that the correctness of the amount shown as accounts receivable depends largely on the methods used to keep a constant check on the activity of employers by a revision of payroll estimates at frequent intervals. The actual assessment roll for any one year cannot be determined until well into the following year and very often owing to audits not being completed, it cannot be determined for two or three years. Most Boards, therefore, work on provisional assessments based on payroll estimates.

The statistical section compiles from claims made, payroll returns received, disbursements and collections, a mass of information that is used chiefly: (1) to ensure that correct rates are charged the various industries each year; (2) to supply information to the Board's inspectors as to hazardous operations; (3) to supply individual operators, or operators in a particular industry, with information as to the cause, nature and cost of accidents; (4) to complete the statistical information for the annual report; (5) to furnish the Board with any information it may require.

The actuarial section is responsible for the setting up and use of correct actuarial tables, the revaluing of pensions reserves at frequent intervals, and it generally acts in an advisory capacity concerning the correctness of reserves, commutations, and other actuarial matters.

Accident Prevention and First Aid Division-The extent of the operations of this division vary greatly in the various provinces. Generally speaking, its duties are the framing and issuing of regulations concerning safety and first aid, the inspection at frequent intervals of hazardous operations. the education of employer and employee as to safe practices, the addressing of meetings of workmen and employers and in extreme cases the closing down of operations where employers fail to comply with regulations and safety requirements. As a rule the employer welcomes inspection and profits by inspectors' experience. It has been recognized that approximately ninety per cent. of all accidents are caused not by faulty machinery or equipment, but by an error of judgment or a slip on the part of the workman. Education by meetings and safety talks by inspectors and key executives, therefore, form a large part of the work of this division, prevention rather than cure being their slogan.

In some provinces, accident prevention and mine rescue work is carried on by outside organizations subsidized partly by the employer and partly by the Board. In mining districts in late years there has been set up a silicosis section of this work. Qualified chemical engineers have been employed to co-operate with the employers in an endeavour to reduce the toll exacted by silicosis. Progress is slow but steps have been taken to limit the number of men working underground to those who are physically fit and to exclude all those with weak or impaired lungs. By improvements in ventilation and by reduction of dust by dampening and other processes, it is hoped eventually to stamp out this scourge. Co-operation has been received from the principal mine operators in this respect.

Assessment Rates—The chief item of interest to an employer in connection with workmen's compensation is the rate that will annually be charged his particular operation. In the whole field of employers' liability insurance, no problem has received more study and investigation by qualified experts than that of rate making. Rates are, as a rule, based on the accident cost in each class of industry and the accident cost is charged to the year in which the accidents occur. Generally the accident cost for five years is taken.

By reason of variation in wage scales and differences in the hazard of industries through changed methods of operation, it is recognized that much of the experience over a longer period is of doubtful value. It is obvious that a sufficient volume of recent experience will reflect more accurately the present requirements than a larger volume of data collected during a period when conditions and benefits were dissimilar to those now prevailing. The art of rate making has been the subject of many published volumes and is, and always will be, a difficult and complicated problem.

Most of the operations covered by the various Acts are under the collective liability system, that is, where the employer is not individually liable for accidents to his workmen but is assessed to provide a general fund out of which accidents occurring in his class of industry throughout the Province are taken care of. Others are under the individual liability system under which the employer is liable to pay accidents happening to his own workmen. Most industries are covered under the collective liability system, while municipal corporations, railways, navigation companies, telegraph and telephone companies and government employees come for the most part under the individual liability system.

Experience or Merit and Demerit Rating or Differential Rating — Differential rating, as the method is called in Eastern Canada, has not been an unqualified success. The last plan adopted by the province of Ontario has been abandoned and refunds made to all employers of assessments in excess of the preferred rate. New Brunswick, which was to have introduced a similar plan in 1938, postponed such introduction for the time being. It has, however, appointed a special committee of the Accident Prevention Association for the purpose of making an intensive study of the matter jointly with the Board. Briefly, the plan provided that employers whose accident costs in any year were 60% or less of their final adjusted assessment, should obtain for the following year a preferred rate of assessment which would be, in general, less than they had been paying in recent years and less than the average for the group. Employers, whose accident costs were more than 60% of their assessments, would receive differential ratings which would be higher than the preferred rate and in accordance

with a certain schedule based on accident costs. This rate in no case would be more than twice the preferred rate.

In British Columbia a system of experience rating has been in existence since 1932 in connection with the lumber industry only. It has been improved from time to time and now gives additional benefits to those firms whose experience merit for the past five years has been twelve per cent. or over. It may be briefly described as the setting of a rate upon an individual employer by which he is penalized, or benefited, according to the high or low cost of his workmen's accidents. This is accomplished without destroying the features of collective insurance. It is based on the ratio of accident cost to assessments for the past three completed years, there being a lapse of one year to enable the audit of the employer's payroll to be completed. A basic rate for the industry is created which it is estimated will produce sufficient income for the Board to cover the accident cost for the year. This basic rate is reduced, or increased. according to the amount that the employer's experience varies from the average. No merit, however, is given until the accident costs are less than 80% of the employer's assessment and no demerit is added until the accident cost is in excess of 120% of the employer's assessment. It is possible in the logging industry, for instance, in British Columbia to have a rate for the same operation as high as \$11.70 per hundred dollars payroll and as low as \$3.42—a difference of \$8.28. Consequently it will be seen that in these operations safe practices pay not only in the reduced toll of human life but also in the reduction of assessments charged to the employer. In calculating the cost of the fatal accidents chargeable to the employer in this regard. most boards take the average cost of all fatal accidents in all industries for the year. This discredits a charge often laid against employers that they employ single men in preference to married men and so avoid the cost of the widow's pension in the event of a fatality.

Capitalized Reserves — The setting up of pension reserves is one part of the Board's operation which has been the cause of much misunderstanding. Stories (particularly in Western Canada) of the fabulous sums hoarded by the Board have been freely circulated and just as freely believed, often by those whose intelligence and education should discredit such rumours. These reserves are created

in accordance with the various acts for the purpose of providing in each year capitalized reserves sufficient to meet the periodical payments of compensation accruing in future years in respect of all accidents which occur during the year. If they were correctly set up and human longevity ran true to form, then there would be exactly enough to pay the pensions set out during the lifetime of the pensioners and on their death the capital sum would have been entirely exhausted. We all know that such perfection cannot exist. Miscalculation in longevity tables, increased or reduced longevity experience at different periods through the past twenty-five years, reduction or increase in interest rates on investments, profit or loss on the sale of securities, world-wide depressions and many other circumstances all tend to produce surpluses or deficiencies. Consequently, it is essential to see that, by correction of tables, revision of interest rates upwards or downwards and by frequent revaluations, the capitalized reserves remain as nearly as possible at the figure that it is estimated will be required in the future. At the best it is an actuarial guess, very often a close guess, but a guess nevertheless. This is not meant as any remark decrying actuaries, as actuaries are absolutely essential to the organization. The actuary, however, must familiarize himself with all the ramifications in connection with workmen's compensation pension claims before he is competent to advise on this work.

Compensation Payable—Just as the chief item of interest to employers is the rate chargeable to their operation, so the workman is chiefly concerned with the amount of compensation he is going to receive. Benefits vary slightly with the various provinces. Temporary total disability payments amount, as a general rule, to two-thirds of the workman's average earnings and, in addition, his hospital and medical costs are paid.

Pensions are given to widows and children of deceased workmen and to workmen who are permanently disabled. The widow's pension ceases when she remarries or dies, and generally the children's pension ceases at the age of sixteen, except in the case of invalid children when it may be continued for life. Pensions are also paid to other dependents on proof of their dependency.

In conclusion it may be said that the various Canadian boards have come through an unprecedented economic disturbance extremely well. It was found almost impossible to anticipate fully the many and diverse effects of the recent depression on the various industries throughout the Dominion. Many of our products are sold in the world market and consequently the volume of production is in a substantial way affected by world conditions. This affects the volume of payroll in most industries and in turn the operations of the compensation boards.

Securities which twenty years ago were considered by competent authorities and by the Legislatures to be safe for Trust Fund investments under the Trustee Act, have in some instances proved otherwise. A number of municipal governments have defaulted in the payment of principal or interest or both and one Provincial Government has defaulted in part in this regard. To offset this the various boards have taken the necessary steps to protect their funds in respect of losses which might occur. Life insurance companies and similar institutions have had a much less favourable experience in this respect than have most workmen's compensation boards. For notwithstanding all their many difficulties, the boards have met their obligations to the workmen and dependents throughout the whole period since their inception and are in almost every case in a sound and enviable position with ample funds to take care of their future liabilities. Their records are always available to the public and their accounts are audited annually, while their pension and reserve funds are revalued at frequent intervals by qualified actuaries.

Recognizing that they are the means by which efficient administration of this important work alone can be carried out, the staffs of the various boards endeavour to give their best, often, possibly, without the recognition which they deserve. There is little doubt, however, that the time will come when service in this valuable branch of the public service will be recognized as a special profession offering a career to those qualified for this exacting type of work.

SOME OBSERVATIONS ON THE PROFESSIONS* By W. M. Rose, K.C., Moose Jaw, Saskatchewan

Your Honour, Mr. President, Ladies and Gentlemen:

I am deeply sensible indeed of the honour conferred on me in giving me the opportunity to address such a gathering of a great sister profession. An old hand at after-dinner speaking, who was somewhat of a Bohemian and who had the courage to tell the truth as he saw it, once remarked that the ideal audience before which to deliver an afterdinner speech was one well educated, intelligent, but at least fifty per cent, inebriated! I feel I have a great audience before me tonight. (Laughter). And if there is any absence of the third ingredient and requisite, then I am sure that absence is more than atoned for by the spirit which I can see has prevailed throughout the whole of this convention. It is a great pleasure also to know that the ladies have succeeded in locating some of their husbands and have managed to bring them here tonight. That bespeaks ingenuity, determination and charm. Will Rogers once remarked, about all he knew concerning the Senate was that it opened with prayer, and closed with an investigation. As far as I can understand, this convention had a formal opening and I feel satisfied after some of the things I have heard, there will certainly be an effort made to prevent an investigation. It therefore logically and mathematically follows that this convention of the Association of Chartered Accountants does not resemble the Senate. What then does the Association resemble? I don't want to be accused of flattery. It appears to me to resemble in many particulars the Association of the Canadian Bar. (Laughter). Chartered accountancy has long since entered into the realm of a profession. One of the characters in one of the novels of Sir Walter Scott said, "The clergy live by our sins, the medical faculty by our diseases, and the lawyers by our misfortunes." Later, the chartered accountant came along and began to live happily on the clergy, on the doctors and their patients, and on the lawyers and their clients as well. And the trouble is that nothing can be done about it. There is no use quarrelling with the chartered accountant. Even

^{*}An address by the President of the Law Society of Saskatchewan at the annual banquet of The Dominion Association of Chartered Accountants. Saskatoon, 24th August 1939.

the lawyer recognizes that, because he can run off a balance sheet, give a summary, make an audit or what you will, and the next thing you know you will find yourself in the red, strangely bewildered, with proof that you are wrong and he is right, and it only remains for you to surrender and allow him to certify that everything is correct. It is maintained by some that as far back as the 16th century there was the first institution of accountancy in Venice, and later in the year 1742 at Milan there was a recognized institute of chartered accountants. In the British Empire Scotland took the lead in 1854 with an institute established at Edinburgh, and then in 1880 I believe it is recorded that in England and Wales, the first institute by Royal Charter was incorporated. The complexities of modern life, industry, trade and taxation have given a great impetus to the development of your profession, and the expansion of the powers and duties pursuant thereto, so that today the chartered accountant is an expert who is consulted in almost every form of commercial activity. One of the most onerous of the many duties of the chartered accountant of today is that of trying to establish harmonious relations between the tax paver or tax evader and the income tax authorities. It has been said some accountants have become so immersed and busy with this work that they haven't had time for anything else; that some have been on the verge of a nervous breakdown, and others have seriously considered offering their services to the foreign office. A great judge and lawyer of Great Britain said a short time ago that he had often heard of a beloved physician, but he regretted to say he had never yet heard of a beloved lawyer. The adjective is certainly not commonly applied to my profession, and I don't think it is extensively used of members of your own, but at the same time it has been my experience and good fortune to know a number of chartered accountants to whom I think the adjective could readily be applied. Notwithstanding the fact that it is not generally applied to our professions, we belong to two great professions; and sometimes I wonder whether it is our fault, or the nature of the profession which prevents us from being so endowed. Every man of course is a debtor to his profession and is called upon to be an ornament and help thereto, but the variety and importance of the work of the accountant, the many duties and calls which are made upon him, necessitate

the possession of some very great qualities. He is required to be honest:-of course with a lawyer that doesn't matter so much, the chartered accountant is required to be honest. He is required to be accurate. He is required to have tact and patience equal to or surpassing the patience of Job. After seeing some of the books that you have examined and audited I realize patience is one of the essential requisites. Courtesy and industry are required, and the chartered accountant is something far more human than a well-oiled adding machine. He occupies a place in the community; he is the guide, guardian and friend of many a distracted citizen, a stabilizing force in the community, and I think it can be said with truth that every side of his profession tends to make him the living active opponent of the scrap-of-paper doctrine in business, in politics and in the world of international affairs. But the profession itself is a profession which particularly requires exactitude. The accountant must be an expert in a very definite and positive way: and this of course has a tendency sometimes to develop narrowness and a feeling of self-sufficiency, which may seem to put men of his profession on a pedestal and away from his fellow men, and to develop a certain amount of cocksureness. Now two and two do not always make four. Coming up from Montreal to Winnipeg last week was a man on the train who besieged the conductor periodically with the question: "How far is it from Montreal to Winnipeg?" He asked the question three or four times before he got to Fort William. Then he transposed the names of the places and asked: "How far is it from Winnipeg to Montreal?" The conductor said: "I have told you three times." "No," the man said, "you have told me how far it is from Montreal to Winnipeg." "Well, it is the same thing," said the conductor. "Not by any means," the man said, "it is only a week from Christmas to New Year's. but it is a devil of a long distance from New Year's to Christmas." Now the chartered accountant in his profession has to fight against mechanism. He has to struggle against being a slave to the great god routine, and he has to fight against the rigidity and warping of heart; he is called upon to war against smug self-satisfaction and self-sufficiency in his profession; he is called upon not to forget that the place of any man is in the community as opposed to a place in his profession, and he is called upon to endeavour not to put

the interests of his craft above the interest of the community—in other words, to be an instrument of progress. You have that problem; we have that problem, by reason of our profession. Medical men have that problem and even the clergy have that problem to a certain extent. "The letter killeth but the spirit giveth life." Even a lawyer can quote scripture. It is my opinion that chiefly for these reasons these annual conventions in the various Provinces, these annual gatherings throughout the various Provinces of the Dominion, are of particular value,—I may say of priceless value. There is an exchange and widening of views in matters pertaining to the profession, but there is something more than that. There is an increase of knowledge as to the conditions of life in various parts of our great Dominion. Every member of every profession who comes to the annual Dominion convention is an ambassador from his Province to the Province to which he goes. He is an ambassador of goodwill. He is a living instrument and force towards the perpetuation of unity throughout the Dominion. You have already had reference made by your past President as to the steps you have taken towards uniformity in the matter of examinations; and it is true today, just as true as it was at the time Shakespeare wrote the words, "Ignorance is the curse of God, and knowledge is the wing wherewith we fly to heaven."

A week ago at the Canadian Bar Association I stood as a member of the Saskatchewan Bar in the storied and picturesque City of Quebec, and I learned at first hand a number of things which I had never known before. Among many of my enlightening and delightful experiences I met a man who is an expert in what is now a profession too. in agriculture and stock raising,-a French Canadian born in the Province of Quebec. He was occupying an important position in the work of the Agricultural Department. He had experimented and prosecuted his studies. He had gone to England and Scotland, to France and to Belgium. He had come back to his native Province, a graduate of his own agricultural college, and as a result of his work of years he had succeded in winning the first prize at the fair in Toronto and the first prize in Montreal for the work he had done. He is a source of inspiration to his fellow students, to his fellow graduates and the students coming up. He is filled with enthusiasm in his work and profes-

sion, and it is so because he is a great Canadian citizen who has got beyond his provincial views and is doing a work for his Province and for Canada to which he is a credit. Every city to which a convention and association gathers is interesting, but the city of Quebec is steeped in history. Foundations were laid there. It is thick with the memories of great names and doings-Champlain, Frontenac, Montcalm, Wolfe, the struggle with the United States in the time of the early days, Carleton, Murray, the steps towards confederation, Cartier, Macdonald and Laurier. It was on the ramparts of Quebec it is said that Daniel Webster the great American orator caught the inspiration for the immortal description which he afterwards gave to the world of the British Empire as a power whose morning drum-beat following the sun and keeping company with the hours circled the earth with one continuous and unbroken strain of the martial airs of England.

In our Province, in our country, in the world, the professional man can and must and will, be found on the right side of the national ledger and also on the right side of the international ledger. While we are gathered here tonight the fate of civilization hangs in the balance. In this solemn hour I don't believe there is a man or woman here who does not proudly feel that we are part and parcel of the British Commonwealth of Nations. (Hear! hear!). I don't believe that there is anyone here who is not sensible of the blessings which we enjoy as part of that commonwealth, freedom of the press, freedom of action, and all the attendant blessings which have been purchased with the blood and the tears of the centuries. And I recall the words that Earl Baldwin spoke only last April in the University of Toronto: "Civilization may perish as a result of war; it would certainly perish as a result of Naziism triumphant beyond the borders of its birth. To whatever ideology a people may submit itself, that is its own concern. but when that system is imposed on other free countries. that is the concern of all free men." (hear! hear! and applause.)

REAL ESTATE AND THE WAR By G. R. G. Baker, Toronto

WHAT is the probable effect of the war upon real estate values? One naturally refers to the experience of the last war for assistance in answering this question, but the present war is already showing such distinctive differences as to make such a comparison, though helpful, not entirely reliable.

Differences in War Situations—We cannot tell how long the conflict will last and this may be an important factor. The last war came at the end of a period of expansion, the present conflict at the close, it appears, of a prolonged period of depression. Values were high before the last war and so were interest rates, but now real estate values are unreasonably low and interest rates almost the lowest on record.

Doubling up of Families—At the beginning of the last war, upon the despatch of a Canadian Expeditionary Force to France, it was inevitable that wives of soldiers should return to live with father or mother or some other relative and this doubling up of families left many vacant houses. Coming upon the heels of a depression the present war found many families had already doubled up, but the movement will undoubtedly be accelerated, as in the war of 1914, when our soldiers begin to go overseas.

Immediate Effects—When war was declared in 1914 there was an immediate cessation in building; buying stopped, purchasers hesitated to make heavy commitments and the real estate market was at a standstill. There was the same hesitation at the outbreak of the present war, but in many lines there is increased buying of products whose purchase may have been long delayed, and now for fear of rising prices buying is accelerated. This may extend to real estate with the same activating influences behind the buying activity. Prices are exceptionally low and almost any purchase of real estate is sure to be a provident one.

Eventual Effects—The prices of all commodities are sure to go up and real estate will too, although not as soon perhaps as other things. The shortage of labour due to the call to arms will restrict the labour market. The increased production of industry to fill war contracts will place in-

creasing demands upon the supply of labour, and wages will eventually rise. As a result the cost of all kinds of products and materials, including building materials, will also increase and the value of existing houses will rise with them. The wages of carpenters, lathers, plasterers and bricklayers will also be affected beneficially by any labour shortage.

Wage earners will be able to afford higher rents; investments in real estate will pay bigger dividends and the holding of real estate will become more attractive.

Effect of Taxes — Another factor which will send up building costs is that of taxes. It is evident now that the government will endeavour to finance as much of the war as possible during its progress and this will have its effect. In 1938 building materials were exempted from sales tax, but the needs of war may well result in the restoration of the tax.

Taxes paid by the makers of building material, which must eventually be paid for in the product itself, are bound to increase as well. This is already evident in the passage of the Excess Profits Tax Act, which takes part of the profits of any company beyond 5% of its capital, or in the alternative one-half of the profit beyond the average annual earnings of the past four years. Supply houses, which have had several lean years, may find a demand for their products from industries that wish to extend their plants owing to war conditions, and under either system taxes will bulk large. These are all factors making for higher building costs and an enhancement of prices for houses.

On the other hand the taxation of real estate is not likely to be any heavier. As everybody knows real property is already bearing its full share of taxation and there would be determined resistance to any increase. So that while there will likely be an attempt on the part of the government to draw off part of the profits which may result from higher prices this is not likely to apply to real estate.

Possibility of Inflation—It has often been said that the buying of real estate is a hedge against inflation and, with the present low prices and the prospect of at least a modified inflation, the saying might wisely be acted upon. There is, however, a great number of properties on the market

for sale and it may take a long time for these to be absorbed, even if there were an increased demand.

The greater war spending may take some time to sift down into the pockets of the man in the street and until it does, demand will not greatly quicken. There may also be other things that he will more readily buy, which he has needed for a long time and which do not require as large a commitment: new clothes, new furniture, perhaps a motor car. These will compete for his earnings.

Interest Rates—It was not until the later phases of the last war, in the beginning of 1917, that real estate began to feel the stimulus of a steady demand and rising prices. Interest rates stiffened and it became more expensive to carry the undertaking of a house purchase.

This experience may not be repeated. The Foreign Exchange Control Board has as part of its purpose the conservation of capital for war financing and by its refusal to allow any substantial export of capital may hope to obtain loans to finance its war needs at rates as low as four per cent.

During the last war Victory Bonds bore interest at five and one-half per cent. and were free of income tax, so that it was no act of great patriotism to invest in them. Real estate loans in competition for such money must needs offer seven or seven and one-half per cent. With a lower rate on government bonds, however, and certainly no exemption from income taxes thereon, borrowers on mortgage security may expect a much lower rate.

Post War Results—While the prospect for real estate during the war has many favourable factors one is inclined to be pessimistic of the post war results. Without claiming to be a seer or a prophet, one can see that there may be trouble ahead. The more that Canada is geared up to a high speed of production, for war materials, and the more men she withdraws from industry to serve overseas, the greater will be the difficulty of adjustment when the war ends.

Factory production will drop off. Unemployment will increase. The return of men from overseas will aggravate this condition as well. Unless Canada finances a great deal of the cost of the war during its progress, the burden of taxes to pay what has been called "the torrent of post war

debts" will swamp her people in their effort to meet them out of a greatly contracted income.

Saving Factors—At the close of the last war there was much rehabilitation work to be done which created a demand for manufactured products, and this helped to bring Canada through what might otherwise have been a period of painful adjustment, although it may have carried the seeds of the crash of 1929.

A similar need for rehabilitation may assist us again, but it is very likely that despite an increased demand for housing, consequent upon the return of men from overseas, rents will decrease because the average man's income is diminished and he has less money available to pay for shelter. When this occurs the price of real estate will drop as well.

FURTHER THOUGHTS ON WAR FINANCE

THERE has been an attempt in these notes to consider some of the aspects of war economics. The position of the economist is that in general the generation which fights the war also bears the burden of the war in that wars are fought with resources of men, machines and materials, and there is no way in which future resources can be used for present purposes. In the case of current war taxation it is clear that the fighting generation bears the cost of the war and it was shown that if the war is financed by loans floated internally the result is not different.

Professor Lionel Robbins in his latest book puts this matter briefly and concisely:

During the Great War of 1914–18 it was often suggested that the financing of expenditure by loans had the effect of throwing the burden on the shoulders of posterity. Taxes were paid out of present resources, it was held; loans drew on the future.

Now this view was erroneous. There is no such simple choice for society. We cannot call future work and future resources to the service of the present. Whether extraordinary expenditure is raised by taxes or by loans, the cost of such expenditure is the sacrifice of the other things which might otherwise have been produced at the time. In the case of loans this sacrifice is borne by the lender: in the case of taxes, by the taxpayer. The idea that the wealth of the society of the future

can be anticipated by the simple expedient of substituting loans for taxes is a fallacy. And expert discussion of these matters has long quite rightly emphasized this point.*

It has been pointed out previously that posterity pays for the war in the sense that it inherits a population and equipment depleted and distorted by the ravages of war. Professor Robbins raises another interesting question. Taxation in the future to meet interest on loans floated during the war may seem to be merely a transfer of income between groups within the country—one group paying the taxes and another group receiving the proceeds of these taxes as interest.

To regard such payments of interest as mere transfers without possible further consequences, however, overlooks certain matters. Heavily taxed citizens may escape taxation by moving themselves and their capital abroad. To prevent this the foreign exchange controls of war-time would have to be carried over into the post-war period and the freer economy of peace would be to that extent delayed in its coming. But there is a more important consideration also involved. It is too easily assumed that, since we have seen the income tax of sixpence in the pound of Gladstone's day become many times as high without killing enterprise. there is no limit to which taxation may not safely go. Robbins protests that even if taxation of the kind we are considering is a mere transfer it does not follow that it is a matter of no significance whether taxation is high or low. He says:

Even so, it is not really open to question that, beyond a certain point, high taxation is likely to have adverse effects on production. Beyond a certain point "mere" transfer from active business to the rentier class does affect the stability of the system. It is quite true that the position of this point is not necessarily fixed. We have all heard, ad nauseam, that, in the time of Mr. Gladstone, people thought that sixpence in the pound income tax would be ruinously oppressive to enterprise, and, that, in fact, enterprise still goes on with the income tax ten times as high. We know that, in time of war or exceptional stress, people will shoulder burdens which otherwise they would not willingly carry. But this does not dispose of the matter. Because people learn to carry heavier burdens that is not to say that there is no burden

^{*}Expert agreement on this matter, however, did not prevent the present Chancellor of the Exchequer from invoking the same hoary fallacy in his statement of 20th February 1939.

that they will not carry. There seems little reason to doubt that a high income tax does tend to damp down enterprise of the pioneering or risk-taking type: and the effect of this on the general rate of investment may at times have even more farreaching repercussions.

The conclusion would seem to be that as heavy taxation as possible should be applied during the war because a given burden of heavy taxation will dampen down war activity much less than a similar rate of taxation would dampen post-war activity. A burden of taxation for posterity, even if it only involves a "mere transfer," may yet make the production income of posterity less than it otherwise would be and in that sense posterity suffers from the war. But their suffering more could in no way allow us to suffer less. In general the war generation fights and pays for the war and it is therefore of the greatest importance that we fight waste as energetically as we fight the enemy.

R. McQueen.

Winnipeg. 21st November 1939.

Editor's Note-We are pleased to bring to our readers the third in a series of brief articles by Professor McQueen. In the October issue he referred to the Budget Speech at the special session of Parliament in September; and in the November issue he made some instructive observations on Canadian agriculture and the war.

EXTENSIONS OF AUDITING PROCEDURE

Editor's Note—In the June 1939 issue of The Canadian Chartered Accountant there was published, with the kind permission of the American Institute of Accountants, the report of the Special Committee on Auditing Procedure of the Institute. On October 18th the Institute issued "Extensions of Auditing Procedure—Report of May 9, 1939, as modified and approved at the Annual Meeting, September 19, 1939," and again has given its kind permission to our Editorial Committee to publish this report in The Canadian Chartered Accountant. The pamphlet containing the report has also a letter of the Secretary to the members of the Institute; both are published hereunder.

TO THE MEMBERS OF THE AMERICAN INSTITUTE OF ACCOUNTANTS:

Gentlemen:

Under date of May 9, 1939, the council of the American Institute of Accountants adopted a report submitted by the special committee on auditing procedure entitled "Extensions of Auditing Procedure," and at the same time it was anticipated that the committee would make a supplemental report at the September meeting. The report of May 9th emphasized that it was the ultimate responsibility of the independent certified public accountant to adopt such procedures as in his professional judgment he deemed appropriate, but recommended that certain additional procedures regarding inventories and accounts receivable should be considered as generally accepted practice. It further recommended that, where these additional procedures regarding inventories and accounts receivable had not been undertaken, that fact should be disclosed in the auditors' report or opinion.

The action of the council received widespread support of state organizations of certified public accountants, and the recommendations evoked the hearty approval of investors, credit grantors, the press, and the public.

During the four months which elapsed between the issuance of the report and the September meeting, the committee had considerable discussion and correspondence with informed people, both within and without the profession, and held a number of meetings. While the recommended additional procedures had the united support of independent accountants, it was evident that there was some misconception as to the meaning intended to be conveyed by the term "physical tests" as applied to inventory quantities,

that considerable misunderstanding had arisen as to the responsibility which the auditor might be assuming, and that the recommended reference in the auditors' report or opinion to the omission of such procedures had been misconstrued.

In its supplemental report presented to council under date of September 18th, the committee explained the term "physical tests" and indicated that in his capacity as auditor the independent certified public accountant could properly attend at the inventory-taking and observe the methods of taking the inventory, making in conjunction therewith such suitable inquiries or requiring such test checks under his observation as he deemed advisable, and that such a program was within the meaning of the term "physical tests."

The auditor's duty was increased in that the additional procedures were adopted as generally accepted practice wherever they are practicable and reasonable, but beyond this the auditor's responsibility remained unchanged. The responsibility of the management for taking proper inventories was again emphasized.

The committee reiterated its recommendation of May 9th that, where exceptions were required, such exceptions should be expressed clearly and unequivocally. However, where exception was not called for under the terms of the report, it was felt that no good purpose would be served by requiring negative explanations, because discussion and experience in the meantime had demonstrated that negative references in the auditors' report gave rise to misconception in that they tended to convey implications of reservations or exceptions where none existed or was intended. In other words, they had the effect of casting an unwarranted cloud on the statements.

The council at its meeting on September 18, 1939, adopted the supplemental report of the committee which, after discussion at the meeting of the Institute on September 19th, was approved. The executive committee was authorized and instructed by council to co-ordinate the two reports into one document and to distribute it to the mem-

bership. This document is submitted herewith; it supersedes the report of May 9, 1939.

Respectfully submitted, EXECUTIVE COMMITTEE

By: John L. Carey, Secretary.

October 18, 1939.

Extensions of Auditing Procedure

Report of May 9, 1939, as Modified and Approved at the Annual Meeting, September 19, 1939

Following the adoption by council on May 9, 1939, of the report of the special committee on auditing procedure entitled "Extensions of Auditing Procedure" and the approval at the annual meeting of the supplementing and interpreting report of the same committee dated September 18, 1939, the executive committee was instructed by council to co-ordinate the two reports into one document and to distribute it. There is presented herewith the modified report which deals with the following matters:

Examination of inventories Examination of receivables

Appointment of independent certified public accountants

Form of independent certified public accountants' report.

Auditing procedures and related matters dealt with herein relate to those cases in which financial statements are accompanied by a report and opinion of an independent certified public accountant. Accordingly, that which follows should be read in the light of this limitation.

At the outset it is pertinent to state that, since the late disclosure of conditions existing in exceptional cases, certified public accountants have been considering possible implications which may arise therefrom in relation to their practice. The committee desires to state its opinion that auditing procedure has kept, and continues to keep, pace with the growth and development of industry and that the well established custom of making test checks of accounting records and related data and, beyond that, reliance upon the system of internal check and control after investigation of its adequacy and effectiveness has with very few excep-

tions proved sufficient for its purpose. Because of public interest and discussion in the press, there is a question now before the profession as to whether its procedures shall be extended. In order to consider the question intelligently there must first be some general understanding of certain fundamentals.

In the performance of his duties as auditor, the independent certified public accountant holds himself out as one who is proficient in accounting practice and auditing procedure. The function of the independent certified public accountant is to examine a concern's accounting records and supporting data, in certain matters to obtain outside confirmations, and to require and consider supplementary explanations and information from the management and employees, to the extent necessary to enable him to form an opinion as to whether or not the financial statements as submitted present fairly the position and the results of periodic operations. Generally speaking, his function is limited to reporting upon situations arising out of business transactions that have taken place in the past. In no sense is he an insurer or guarantor. In offering his opinion, the independent certified public accountant assumes heavy responsibilities. He must be skilled in his professional work and must have made a reasonable examination of the accounts in order to warrant his expression of an opinion. He must state his opinion clearly and unequivocally.

Management itself has the direct responsibility for the maintenance of an adequate and effective system of accounts, for the proper recording of transactions in the books of account, and for the safeguarding of the assets of a concern. It is also charged with the primary responsibility to stockholders and to creditors for the substantial accuracy and adequacy of statements of position and operations.

In order to qualify himself to carry out his function, the independent certified public accountant has completed a rigorous course of professional study and training as a background to the essential practical experience he must obtain, for it is only by study, training, and practical experience that the independent auditor acquires skill in accounting and related matters. In the ordinary course of his day-to-day practice, he encounters a wide range of judgment on the part of management, varying from true objective judg-

ment to the occasional extreme of deliberate misstatement. He is retained to examine and report upon the affairs of a concern because, through his training and experience, he has become not only skilled in accounting and auditing but has acquired the ability and habit of considering dispassionately and independently the facts recorded in books of account or otherwise disclosed by his examination and because, as a result, his opinion provides reasonable assurance that a fair and adequate presentation of pertinent information has been made in the financial statements.

The independent auditor must also exercise his best judgment in determing the scope of his examination and in deciding whether the interests of stockholders and creditors justify the time and expense involved in the extension of any particular line of inquiry. Experience shows that, with few exceptions, the personnel of business organizations is honest. The ordinary examination incident to the issuance of financial statements accompanied by a report and opinion of an independent certified public accountant is not designed to discover all defalcations, because that is not its primary objective, although discovery of defalcation frequently results. In a well organized concern the principal reliance for the detection of such irregularities is placed upon the maintenance of an adequate system of accounting records with appropriate internal check and control. is the duty of the independent auditor to review the system of internal check and accounting control so as to determine the extent to which he considers that he is entitled to rely upon it. To exhaust the possibility of exposure of all cases of dishonesty or fraud, the independent auditor would have to examine in detail all transactions. This would entail a prohibitive cost to the great majority of business enterprises-a cost which would pass all bounds of reasonable expectation of benefit or safeguard therefrom, and place an undue burden on industry.

In carrying out his work the independent certified public accountant must always be on his guard against collusive fraud and be alert in detecting any sign of such collusion. However, on the basis of his examination by tests and checks, he relies upon the integrity of the client's organization unless circumstances are such as to arouse suspicion, in which case he must extend his procedures to determine whether or not such suspicions are justified.

The independent certified public accountant should not express the opinion that financial statements present fairly the position of the company and the results of its operations, in conformity with generally accepted accounting principles, when his exceptions are such as to negative the opinion, or when the examination has been less in scope than he considers necessary. In such circumstances, the independent certified public accountant should limit his report to a statement of his findings and, if appropriate, his reasons for omitting an expression of opinion.

Turning now to consideration of the specific matters referred to at the beginning of this report, it may be noted in passing that in some cases independent certified public accountants have attended at the inventory taking or observed physical test checks of inventories and have confirmed receivables by direct communication with debtors. Such steps, however, have usually been undertaken as additional procedures under arrangement with the client, or where the accountant thought them essential or desirable in a particular case.

It is believed that recognition should be given to the widespread demand for an extension of auditing procedures with regard to inventories and receivables. However, it should be noted that additional expense to business will be involved in the added procedures.

INVENTORIES

Added steps may well be taken to give greater assurance with regard to inventories. The extent of such additional procedures will necessarily vary with the circumstances, because the independent auditor is justified in giving consideration to the effectiveness of the internal check and control as applied not only to book records, but also to the procedure of taking physical inventories. But, however extensive these may be, the training and experience of an independent certified public accountant do not qualify him as a general appraiser, valuer, or expert in materials. The public should understand that, while he can in his capacity as an auditor undertake additional procedures as to inventories, such procedures do not invest his opinion with a degree of authority which he does not claim for it or impose upon him a measure of responsibility which the nature of his work does not justify. Such procedures are

only for the purpose of satisfying himself as to the credibility of the representations of the management regarding quantity and condition.

Taken in consideration with the foregoing discussion of auditing procedures, the following recommendations are made concerning inventories:

(A) That hereafter, where the independent certified public accountant intends to report over his signature on the financial statements of a concern in which inventories are a material factor, it should be generally accepted auditing procedure that, in addition to making auditing tests and checks of the inventory accounts and records, he shall, wherever practicable and reasonable, be present, either in person or by his representatives, at the inventory taking and by suitable observation and inquiry satisfy himself as to the effectiveness of the methods of inventory taking and as to the measure of reliance which may be placed upon the client's representations as to inventories and upon the records thereof. In this connection the independent certified public accountant may require physical tests of inventories to be made under his observation.

In cases where the inventory is determined solely by means of a physical inventory at the end of the accounting period (or at a date prior or subsequent thereto but within a reasonable time thereof, with adequate records supporting the interim changes), it will ordinarily be necessary for the foregoing procedures to be followed at that time.

In cases where the concern maintains well kept and controlled perpetual inventory records supported by (1) a complete physical inventory at a date not coincident with the balance-sheet date, or (2) physical inventories of individual items taken from time to time so that the quantity of each item on hand is compared with the inventory record for that item at least once in each year, it will be satisfactory to undertake the procedure outlined at any interim date or dates selected by the auditor, his purpose being to satisfy himself as to the credibility of the perpetual inventory records and whether they may be relied upon to support the inventory totals as shown on the balance-sheet.

(B) That hereafter, in the case of inventories which in the ordinary course of business are in the hands of public warehouses or other outside custodians, direct confirmation in writing from such custodians is acceptable procedure; except that, where the amount involved represents a significant proportion of the current assets or of the total assets of a concern, the independent certified public accountant shall make supplementary inquiries.

It should be clearly understood that in undertaking these auditing procedures regarding inventories, the independent certified public accountant does so for the purpose of satisfying himself as to the credibility of the representations of the management regarding quantity and condition and does not hold himself out as a general appraiser, valuer, or expert in materials.

The general adoption of such added procedures regarding inventories may necessitate procedural changes on the part of clients. So many corporations close their books upon a calendar-year basis that it is doubtful whether the profession as at present organized can undertake the additional work adequately and satisfactorily on the last day of each year. Many corporations do not have adequate perpetual inventory records and greater use of them should be encouraged.

The extension of procedures regarding inventories would be greatly facilitated if each concern adopted its natural business year instead of the calendar year as its fiscal year, and introduced continuous well kept perpetual inventory records.

The proposed changes will take time to bring about, and in the meantime the profession may well be faced with the necessity of submitting qualified reports in those cases in which it has been impracticable to carry out the added procedures.

RECEIVABLES

In regard to the question of confirming receivables by direct communication with the debtor, the following recommendation is made:

That hereafter, wherever practicable and reasonable, and where the aggregate amount of notes and accounts receivable represents a significant proportion of the current assets or of the total assets of a concern, confirmation of notes and accounts receivable by direct communication with the debtors shall be regarded as generally accepted

auditing procedure in the examination of the accounts of a concern whose financial statements are accompanied by an independent certified public accountant's report; and that the method, extent, and time of confirming receivables in each engagement, and whether of all receivables or a part thereof, be determined by the independent certified public accountant as in other phases of procedure requiring the exercise of his judgment.

APPOINTMENT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Apart from the specific phases of auditing procedure which have been the subject of consideration, the method of appointment of the independent auditor and his status in relation to the client are believed to be subjects of great importance to stockholders and creditors.

To emphasize the auditor's independence of the management, some corporations affected by public interest have adopted the practice of having the independent auditor engaged or nominated by the board of directors or elected annually by the stockholders. Other corporations have provided that the stockholders be given an opportunity to ratify the selection made by the directors.

It is suggested that the auditor should be appointed early in each fiscal year so that he may carry out part of his work during the year.

FORM OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S REPORT OR OPINION

The services which independent auditors render usually culminate in a report, which may take varying forms. In some cases a detailed report is rendered, accompanied by statements and supporting schedules; in other cases the report is limited to a concise statement of the scope of the examination and the related opinion of the independent auditor concerning the accompanying financial statements of the client. For present purposes the discussion is confined to the short form of auditor's report, which is sometimes described as a certificate. The terms "report," "opinion," "report and opinion," and "certificate" have been used interchangeably. As uniformity is desirable, either of the words "report" or "opinion" is recommended for general use. The word "report" has been adopted in the following comments.

In January, 1934, the Institute issued a pamphlet entitled Audits of Corporate Accounts, dealing with a standard form of auditor's report. The short form of report then recommended, and since widely adopted by the profession, met a long-felt need.

Developments during the five years in which the standard form of report has been used indicate the need of revision in the interest of clarity. The revised short form of report consists of two paragraphs. The first contains a brief statement of the scope of the examination, and the second deals with the auditor's opinion on the financial statements of the client as a result of his examination.

The major changes recommended pertain to the description of the scope of the examination, specifically to include reference to the system of internal control. The phrase "obtained information and explanations from officers and employees of the company" has been omitted because it is inherent in all auditing procedure to obtain information and explanations from officers and employees concerning the accounts, either as supplementing information obtained from other sources or as constituting the only available information on the subject. In the latter case, the auditor must decide, in view of all the circumstances, whether he should rely upon such information without disclosure of the source. The phrase in question has led to serious misconception as to the degree of reliance on such information and explanations. The sense of the statement "but we did not make a detailed audit of the transactions" has been retained in a revised form. It will be recalled that this clause was included in the standard form of 1934 in order to make clear that the auditor's usual procedure consisted of testing and sampling rather than a detailed audit. It is believed that the business and financial public now fully understand that, in a well organized concern, the detection of irregularities is primarily a matter of internal procedure, and that testing and sampling to determine whether such procedure is adequate in scope and effective in operation is the usual practice of the independent auditor. Nevertheless, it is considered advisable for the purpose of emphasis to include the phrase, "without making a detailed audit of the transactions." There has been excluded the phrase "based upon such examination," as it is obvious that the independent certified public accountant can express an opinion only

after he has completed the work set forth in the first paragraph of the report.

The independent certified public accountant should recognize that in some cases the revised short form recommended may not be altogether appropriate. For instance, there may be cases where the auditor may prefer to alter the first sentence of the standard short form, substituting some words to the effect that the accounting records (instead of the financial statements) have been examined. Obviously, also, it would be erroneous to mention internal control if none existed. Accordingly, while the proposed form is submitted as a standard, it is not prescribed or recommended for invariable use, but should be adapted to the needs of the particular case. For example, the report may be used in connection with an examination covering a period of years, in which case a modification of language would be necessary. Also, in new engagements appropriate investigations relating to prior years will have to be made to justify the use of the short-form report. However, in the interest of reasonable uniformity it is recommended that the substance of phrases in the standard form be used unless inappropriate.

In considering the independent certified public accountant's opinion, the reader should bear in mind one of the most important underlying concepts of financial statements, viz., that normally many of the assets of a concern are not realizable in cash, but are commonly stated at their historical cost or going-concern basis at amounts which are usually greater than the realizable value in forced liquidation. Again, the true profit or loss of a concern can be determined with accuracy only over its entire existence. Therefore, in any attempt to allocate to specific periods profit or loss applicable thereto, it must be recognized among other considerations that, as many transactions are not fully completed within such periods, the result as shown must contain many estimates and approximations in the endeavor to present fairly the operating results of a period in conform-

ity with generally accepted accounting principles.

Assuming that normal procedures have been carried out, it is not considered necessary to describe the details of the examination in this form of report. Any such details as are given should be included in separate paragraphs of the report. For example, reference may be made to procedures

which the accountant has adopted regarding the examination of inventories and receivables; also, it may be pertinent to mention the fact that certain portions of the auditor's work have been carried out at different times during the course of the year. This may be indicated by inserting the words "at times" in the first paragraph of the short form of report immediately after the words "by methods."

It should be borne in mind that the financial statements, with all supplemental descriptive and explanatory data, including footnotes, are regarded as representations of the client. It is upon all these representations that the independent certified public accountant renders his opinion. If he considers explanations essential or desirable, and they have not been made in the financial statements, it will be necessary for him to make such explanations in a separate paragraph of his report.

In explanation of the general principles governing the auditor's opinion, with particular regard to explanations and exceptions, it is pertinent to state that the auditor satisfies himself as to the fairness of the statements "by methods and to the extent he deems appropriate," in general conformity with the auditing procedures recommended in the Institute's bulletin Examination of Financial Statements. Ordinarily, if he has so satisfied himself, he is in a position to express an unqualified opinion. However, if he considers it in the interest of clear disclosure of material fact to include explanations of procedures followed, he is free to do If, on the other hand, such disclosures are made by reason of any reservation or desire to qualify the opinion, they become exceptions and should be expressly stated as such in the opinion paragraph of the auditor's report. As previously stated, if such exceptions are sufficiently material to negative the expression of an opinion, the auditor should refrain from giving any opinion at all, although he may render an informative report in which he states that the limitations or exceptions relating to the examination are such as to make it impossible for him to express an opinion as to the fairness of the financial statements as a whole.

It is desirable as a general rule that exceptions by the independent certified public accountant be included in a paragraph separate from all others in the report and be

referred to specifically in the final paragraph in which the opinion is stated. Any exception should be expressed clearly and unequivocally as to whether it affects the scope of the work, any particular item of the financial statements, the soundness of the company's procedures (as regards either the books or the financial statements), or the consistency of accounting practices where lack of consistency calls for exception.

It is the responsibility of the accountant—and one which he cannot escape—to determine the scope of the examination which he should make before giving his opinion on the statements under review. If in his judgment it is not practicable and reasonable in the circumstances of a given engagement to undertake the auditing procedures regarding inventories and/or receivables set forth in this report as generally accepted procedure and he has satisfied himself by other methods regarding such inventories and/or receivables, no useful purpose will be served by requiring an explanation in his report. If physical tests of inventories and/or confirmation of receivables are practicable and reasonable and the auditor has omitted such generally accepted auditing procedure, he should make a clear-cut exception in his report.

It is worthy of repetition that the extent of sampling and testing should be based upon the independent auditor's judgment as to the effectiveness of internal control, arrived at as the result of investigations, tests, and inquiries. Depending upon his conclusions in this respect, the independent certified public accountant should extend or may restrict the degree of detailed examination. Consequently, in some cases it may be necessary to modify or omit reference to reliance upon the system of internal control. Clearly also where a detailed examination is made, the phrase "without making a detailed audit of the transactions" would be inappropriate.

It is contemplated that, before signing a report of the short-form type suggested, the independent certified public accountant will be satisfied that his examination is in conformity with the procedures and practices outlined in Examination of Financial Statements, a bulletin published by the American Institute of Accountants in January, 1936, or in any subsequent revision thereof.

The report should be addressed to the board of directors or the stockholders if the appointment is made by them.

The description of the financial statements in both paragraphs should of course, conform to the titles of the accompanying statements.

In consideration of the foregoing remarks the following short form of report is recommended:

SHORT FORM OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT'S
REPORT OF OPINION

To the Board of Directors (or Stockholders) of the XYZ Company:

We have examined the balance-sheet of the XYZ Company as of April 30, 1939, and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate.

In our opinion, the accompanying balance-sheet and related statements of income and surplus present fairly the position of the XYZ Company at April 30, 1939, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

It is worthy of repetition and emphasis that, while the proposed form is submitted as a standard, it is not prescribed or recommended for invariable use but should be adapted to the needs of the particular case.

PIONEER LAUNDRY AND DRY CLEANERS CASE

Appeal Allowed by Privy Council

In our November issue a brief reference was made to the fact that the judicial committee of the Privy Council had given its decision in the case of *Pioneer Laundry and* Dry Cleaners Limited v. The Minister of National Revenue and had allowed the appeal. A copy of the judgment has now been received. The decision of the judicial committee was delivered by Lord Thankerton on 13th October last.

It is not necessary to refer again to all the details of the case since these were given in volumes 32 and 34 of The Canadian Chartered Accountant when the appeals were heard in the Exchequer Court and the Supreme Court. It will be noted at page 46 of our January 1939 issue that the two dissenting justices of the Supreme Court—the Chief Justice and Mr. Justice Davis—disagreed with the Judge of the Exchequer Court that the Minister could look behind the legal entities involved and refuse an allowance for depreciation on the basis that the successor corporation had the same shareholders as the prior corporation. That is, in their opinion, the discretion of the Minister should have been exercised on proper legal principles.

The following are the concluding words of Lord Thankerton:

Their Lordships agree with the Chief Justice and Davis J. that the reason given for the decision was not a proper ground for the exercise of the Minister's discretion, and that he was not entitled, in the absence of fraud or improper conduct, to disregard the separate legal existence of the appellant company and to enquire as to who its shareholders were and its relation to its predecessors. The taxpayer is the company, and not its shareholders. Their Lordships agree with the reasons given by these learned Judges, and their application of the authorities cited by them, and it is unnecessary to repeat them.

It follows that the assessment should be set aside, and the matter should be referred back to the respondent. It becomes unnecessary to consider a further question which was debated, namely, as to whether a tax-payer, who has already received in previous tax years allowance for depreciation amounting to 100 per cent.

of the book value of the assets, is entitled to any further allowances.

Their Lordships will therefore humbly advise his Majesty that the decisions appealed from should be set aside, and that the assessment should be set aside and the matter referred back to the Minister. The appellant will have the costs of this appeal and the costs in the Courts below.

CENTRAL MORTGAGE BANK

The Government announced on November 14th through the medium of the press that they had decided that it was not in the public interest for the Central Mortgage Bank to start active operations for the time being. According to the press statement the Act was proclaimed on July 14th but before the Bank could start business, the Cabinet must fix a date on or after which the bank could enter into the membership agreements with the lending companies, in order to permit adjustments to be made in accordance with the Act.

It would appear from the announcement made that the Act will not be repealed and the bank will retain its corporate structure and, as opportunity offers, will be in a position to pursue certain phases of its activities, particularly research and investigation respecting loans on real estate security. The Minister of Finance is quoted as saving that a fundamental factor in the mortgage bank scheme was the revaluation of mortgage properties. In the opinion of the government, however, the existing state of war and the uncertainties regarding the effect war might have on incomes and real estate values made conditions so abnormal and unstable that it would be impracticable at the present time to make, with any degree of assurance. valuations that would provide an equitable and permanent basis for sound debtor-creditor relationships. The further consideration was mentioned that the adjustments contemplated by the Act involved the use of the national credit on a substantial scale and this also seemed undesirable in view of the very heavy present and prospective demands upon the national resources for war purposes.

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GENERAL NOTES

Our Contributors This Month

George R. G. Baker who writes on "Canadian Real Estate and the War" in this issue needs no introduction to our readers as he has contributed several interesting articles published in previous issues of the Magazine.

W. M. Rose, K.C., President of the Law Society of the Province of Saskatchewan, was the guest speaker at the banquet closing the annual meeting of The Dominion Association of Chartered Accountants at Saskatoon in August 1939. His address on that occasion is published in this issue.

F. C. SWALLOW, whose article "Workmen's Compensation Legislation and Its Administration in Canada" is published this month, first came to British Columbia from England in 1912, but returned there in 1914 and, after war service, wrote the final examinations and became a member of The Society of Incorporated Accountants and Auditors in 1919. After practising in England for several years he again came to Vancouver in 1927 and was employed by Messrs. Helliwell, Maclachlan and Company, chartered accountants, until 1932 when he was appointed Comptroller of the Workmen's Compensation Board of British Columbia. He became a member of the Institute of Chartered Accountants of British Columbia in the same year.

Chartered Accountants and the War

From time to time information is reaching the Editorial Committee from the Secretaries of Provincial Institutes concerning members who are becoming engaged in activities arising out of the participation of Canada in the War. Following is a memorandum of brief particulars received during November.

R. B. Mowat, Toronto, has been appointed a Captain in the Black Watch Regiment of Canada.

Maurice Samson, Quebec, was appointed early in October by the Dominion Government as Hides and Leather Administrator. The duties of this office include the conducting of negotiations with England, Australia, New Zealand, Argentina and other countries in arranging for supplies of hides and leather to be imported into Canada, the supervision of the purchase, shipment, delivery and allocation of both domestic and imported supplies, together with broad powers of control over prices.

- C. G. Sherwood, Toronto, has been appointed to the staff of the Toronto office of the Foreign Exchange Control Board.
- G. P. Strickland, Toronto, has been appointed to the staff of the Foreign Exchange Control Board at Ottawa.
- R. F. Bruce Taylor, Toronto, has been appointed Toronto Representative of the Commercial Section of the Foreign Exchange Control Board.

Lieut.-Colonel R. R. Thompson, M.C., V.D., Professor of Accountancy at McGill University, is giving courses of lectures on recent developments in arms, tactics and organization, for active and reserve officers. The course is under the auspices of McGill Contingent, C.O.T.C. Colonel Thompson spent last summer in Great Britain in a course of training to bring himself up to date in military matters.

- D. Fraser Wilson, Toronto, has been appointed to the staff of the Foreign Exchange Control Board at Ottawa.
- G. T. N. Woodrooffe, Toronto, has been appointed to the staff of the Toronto office of the Foreign Exchange Control Board.

In our last issue it was stated that David Young had been appointed custodian of enemy property. It is common knowledge that the duties of the custodian of enemy property are vested in the Secretary of State, and Mr. Young points out that his duties consist in the carrying out of the instructions of the Custodian. We are glad to be able this month to make this correction.

Canadian Investments Abroad

At this time when a state of war exists between Canada and Germany, *The Financial Post*, in a recent issue, carried a timely article on the investments in securities, plants, etc. owned by Canadian companies in foreign countries and comments on their position under present conditions. The conclusion is reached that only a relatively small volume of Canadian investments abroad are likely to be affected seriously by the war. Outside of the United States and Great Britain, in which countries the bulk of Canadian

interests lie, a large part of the remaining holdings are in South America, other empire countries and Scandinavian Europe, with comparatively little in the immediately affected war zones.

Figures taken from a recent study of the Dominion Bureau of Statistics on "The Canadian Balance of International Payments" show the distribution of Canadian investments abroad. At the end of 1937 investments amounted to \$1.758 millions of which \$41 millions were in the United Kingdom, \$1,098 millions in the United States and \$619 millions in all other countries. Insurance assets totalling \$601 millions held outside Canada appear to be readily marketable and reasonably safe. Bank assets are also considered to be fairly secure. Out of a total of \$510.7 millions of assets held by Canadian parent companies engaged in merchandising, manufacturing, mining, petroleum, public utility and miscellaneous business enterprises abroad \$327.4 millions were invested in the United States, \$13 millions in Great Britain and the remainder in other countries. A great deal of this balance is scattered through neutral countries and other areas at present far removed from the European theatre of war.

Establishment of War-time Prices and Trade Board

One of the first actions of the Dominion government on the outbreak of war was to create machinery for safeguarding against undue increases in the prices of food, fuel and other necessaries of life. An article in a recent issue of The Labour Gazette describes the purpose and powers of the War-time Prices and Trade Board, to which body is entrusted the regulation of trade practices affecting necessaries of life. Wide powers for investigating and regulating dealings in necessaries are conferred on the Board. but certain of the more extensive powers can be invoked only by approval of the Governor in Council as the need may arise. The Board, under these powers, if it is deemed necessary for the prevention of excessive demand or excessive prices in regard to any necessary of life, may license manufacturers or dealers, fix maximum prices, or take steps to require equitable allocation of quantities of goods among distributors and regular distribution to consumers.

If these powers are invoked by order in council it shall

become an indictable offence for any person to sell or offer for sale any necessary of life at a price higher than is reasonable or just, and in any event not above any maximum price set by the Board, or to "unduly prevent, limit or lessen the manufacture, production, transportation, sale, supply or distribution of any necessary of life."

Longevity of Industrial Policyholders

According to the Statistical Bulletin of the Metropolitan Life Insurance Company, a new high point of 61.9 years for the expectation of life at birth for industrial policyholders of that company was reached in 1938 as a result of the unusually favourable mortality conditions prevailing during that year. By achieving this mark the group of insured wage-earners and their dependents have established a gain of 15.3 years in their expectation of life at birth since 1911-12, the earliest period for which a corresponding life table was prepared. Thus, in 28 years, industrial policyholders have increased their average length of life (expectation of life at birth) by practically one-third over the initial point, namely, 46.6 years in 1911-12.

A study of the table of mortality rates of that company reveals a condition regarding coloured persons of which many of our readers may not be aware. Statistics show the disadvantage of coloured persons as compared with white persons in respect of age. Specific mortality rates on adolescence and early maturity among coloured persons are eighty per cent. greater than among the white population of the same age; and between the ages of 15 and 35 years, coloured males have twice the mortality rates of white males, while coloured females within the ages from 15 to 25 have practically three times the mortality of white females. From age 25 up to age 50 the mortality of coloured women is at least twice that of white women.

LEGAL DECISIONS

[EDITOR'S NOTE: The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the Dominion Law Reports. In each case reference is made to the volume of the Reports where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Companies Act (Ont.), s. 208(2)—Dissolution of company— Assets not fully accounted for—Absence of fraud—Rights of shareholders

(Christie et al. v. Edwards)

Ontario Court of Appeal

Except upon proof of fraud, a company will be deemed dissolved by operation of s. 208(2) of the Companies Act, R.S.O. 1937, c. 251, as against shareholders who consented to a resolution for its voluntary winding-up and approved the liquidator's report of his distribution of the assets wherein he provided for his retention of a large sum for further expenses, although such sum is not accounted for.—[1939] 4 D.L.R. 139.

Companies — Winding-up — Trust company — Unclaimed trust funds and dividends—To whom payable

(Re Imperial Canadian Trust Co.)

Manitoba King's Bench

A trust company, now in liquidation under the Winding-up Act, R.S.C. 1927, c. 213, held certain assets under an agreement with a loan company to the credit of the latter's depositors. The liquidator paid some of the depositors' claims out of such assets but still retained a substantial unclaimed balance representing claims which had lain dormant for years. He also held a sum representing unclaimed dividends of the general creditors. Held: (1) the unclaimed depositors' moneys were bona vacantia, hence "royalties" under s. 109 of the B.N.A. Act and therefore payable to the Crown in the right of the Province; (2) the unclaimed general creditors' dividends were payable to the Minister of Finance pursuant to ss. 139 and 140 of the Winding-up Act.—[1939] 4 D.L.R. 75.

Income tax—Insurance policy—Option to take lump sum or monthly payments—Whether monthly payments income

(Shaw v. Minister of National Revenue)

Supreme Court of Canada

A woman purchased an insurance policy on her husband's life wherein the insurer agreed to make 120 successive monthly payments of a specified amount upon the husband's death or, at the purchaser's option, to make a lump sum settlement. On the husband's death the purchaser did not exercise the option and insurer made the monthly payments. Held, such payments were proceeds of the policy and not income from the proceeds thereof, and hence were exempt from income tax under s. 3(b) of the *Income War Tax Act*, R.S.C. 1927, c. 97.—[1939] 4 D.L.R. 81.

Income tax—Redemption premium on shares—Surplus account—Whether "undistributed income on hand."

(Massey's Executors v. Minister of National Revenue)

Exchequer Court of Canada

A redemption premium on shares which is charged against the company's surplus account, i.e., the accumulated undistributed annual net profits, is paid out of "undistributed income on hand" and is subject to income tax under s. 17 of the *Income War Tax Act*, R.S.C. 1927, c. 97 [as it stood prior to 1934, c. 55, s. 9], notwithstanding that the undistributed annual net profits had been employed as working capital and the funds in the company's bank account at the time the premium was paid were the proceeds of a new capital issue and of trading operations.—[1939] 4 D.L.R. 225.

(NOTE: A report of this judgment was published in the January 1939 issue of The Canadian Chartered Accountant.)

Sales tax—Corporation forming partnership to sell products —Basis of sales tax

(Canada Rice Mills Ltd. v. The King)

Judicial Committee of the Privy Council

A previous reference was made at page 54 of the July 1939 issue of The Canadian Chartered Accountant to the

judgment of the Exchequer Court of Canada in this case. This judgment was affirmed, on appeal, by the Supreme Court of Canada, [1939] 2 D.L.R. 544, and, on further appeal, was subsequently reaffirmed on 14th July 1939 by the Judicial Committee of the Privy Council.

For report of judgment of the Privy Council see [1939] 3 D.L.R. 577.

PERSONALS

Messrs. Price, Waterhouse and Company take pleasure in announcing the admission to partnership of Messrs. H. P. Herington, F.C.A., and A. F. King, C.A., both of whom have been attached to the Toronto office of the firm for a long number of years.

OBITUARY

The Late Burpee A. Coldwell

The Society of Chartered Accountants of the Province of Quebec regrets to announce the death at Montreal on Sunday, November 19th, of Burpee A. Coldwell, a member of the Society since December, 1928.

Mr. Coldwell was a native of Annapolis Valley, Nova Scotia, and was 61 years of age. He was educated at Acadia University and practised as an accountant in Amherst, Nova Scotia, until ten years ago when he came to Montreal and joined the firm of R. Schurman & Company.

STOCK BROKERS' ACCOUNTS

This series of discussions on the subject of stock brokerage accounting theory and practice has been prepared by a group of members of the profession familiar with the subject. They desire to have it understood that the definitions, opinions and observations appearing in this column are their own and are not necessarily those of the Dominion Association.

(Continued from October issue)

Clearing Sheet

The purpose of a clearing house in connection with a stock exchange is to have one central place where all settlements of transactions between member brokers may be made. Instead of Broker A settling with the individual other brokers for transactions between them during the day, he is enabled by the clearing house to deliver or receive, as the case might be, the net of each stock transacted in during the day and settle for the net money balance of all transactions by a cheque either to or from the clearing house. The medium used by each broker to report his transactions to the clearing house is called the Clearing Sheet.

In the case of the Toronto Stock Exchange there is a two day clearing; that is, transactions (except for "leave offs," explained below) will be settled on the second day after the transactions have been made. For example, the trades of November 1st would be written up on clearing sheets November 2nd and settled on November 3rd. Upon receipt of all clearing sheets, the clearing house staff would check all "bought" items shown on the sheets against corresponding "sold" items on other sheets. The total amount of settlement cheques to be paid by the brokers to the clearing house will equal the total amount of settlement cheques to be issued by the clearing house.

Leave Offs—If a broker finds he will be unable to make delivery of an item on the day it would ordinarily be cleared, he will leave this item off his clearing sheet and telephone the other broker concerned in the transaction to do likewise.

Put Ons—When a broker finds he can make delivery of an item previously a "leave off," he will put this item on his clearing sheet and telephone the other broker concerned to do likewise.

Lieu Cheques-Sometimes a broker finds, after his clearing sheet has been turned in to the clearing house. that he will be unable to make delivery on settlement date of an item appearing thereon. This may be due to the failure on the part of a client to deliver to the broker the stock sold for him, or the client turning in certificates that are not good delivery, etc. It is, of course, too late for the broker to arrange a "leave off." His procedure then is to arrange for a "lieu cheque" in place of the security. He would ascertain from the clearing house the names of brokers receiving this security and contact one who will temporarily accept a cheque in place of security. amount of such cheque would be the current market value of the security involved. Later when the broker finds he can make delivery of the security, he will advise the other broker and each will put such item on their clearing sheets.

To illustrate the preparation of a Clearing Sheet, Schedule A has been drawn up for a day's transactions of Broker A, as follows:

R	ГΤ	v	Q	
D	v	-	N	

	10	Foods, Limited	from	Broker	B	0	70.00	
	100	Mining Company, Limited	from	Broker	C	0	8.00	
	200	Motors, Limited	from	Broker	D	0	10.00	
	100	Amusements, Limited	from	Broker	B	0	20.00	
SE	LLS:							
	50	Mining Company, Limited	to	Broker	10	0	8.10	
	100	Motors, Limited	to	Broker	F	0	10.10	
	100	Biscuits, Limited	to	Broker	C	0	5.00	

200 Chemicals, Limited to Broker G @ 15.00 The following "leave offs" and "put ons" have been telephoned:

LEAVE OFFS:

10	Foods, L	imited	from	Broker	B	@	70.00
100	Biscuits,	Limited	to	Broker	C	0	5.00

PUT ONS:

1 01	10.						
100	Tractions,	Limited	from	Broker	B	0	15.00
100	Aircraft, I	Limited	to	Broker	C	0	25.00

(Schedule A on next page)

SCHEDULE A

BROKER A'S CLEARING SHEET

To Receive

To Deliver

20.00 2,000.00 200 Chemicals, Limited Broker G 15.00 3,000.00 15.00 1,500.00 100 Aircraft, Limited Broker C 25.00 2,500.00 \$6.15.00 450 \$6.915.00 450 To Receive	Motors, Limited Broker C Motors, Limited
To Receive Mining Company, Limited Motors, Limited Motors, Limited Traction, Limited	Amusements, Limited Broker B Traction, Limited Broker B Cheque (from Clearing House)
Mining Company, I Motors, Limited Amusements, Limite Traction, Limited	
	To Deliver
008	

TERMINOLOGY DEPARTMENT

The articles in this Department, unless otherwise stated, are originally written by the Chairman of the Terminology Committee and submitted to the members thereof; they are afterwards revised by him after consideration of suggestions made by the members.

If it should be thought that any articles include too much primary or elementary matter, readers are asked to realize that the Committee hopes these articles will be of especial value to Students-in-Accounts; and it is believed that, to impart a thorough understanding, too much emphasis cannot be placed on the fundamental principles on which the ideas connoted in the term defined are based.

(Continued from November issue)

Short Rate: In insurance, the rate charged for a period less than a year, higher proportionately than the full annual rate. It comes into consideration usually on the cancellation of a policy before its expiry date; also in the valuation of unexpired premiums for other than going concern purposes.

Short Term Liabilities: Current liabilities; usually those maturing in less than one year.

Single Entry: An incomplete recording of the transactions of a business. It is sometimes called an "incomplete system," etc. It may consist of a cash book only, or, in further extensions, a cash book and a customers' ledger. It is submitted that the term be abolished from accounting parlance, and relegated to the limbo of obsolete and forgotten terms. It is essentially not a "system," nor has it any rules or regulatory theories to support it; books kept on this so-called "system" are entirely at the whim or fancy of the individual bookkeeper. In auditing such books, the auditor must necessarily complete, at least in his working papers, the entries necessary to obtain the effect of double entry, and since the layman is disposed to think it is a "system" as long as teaching bodies refer to "single and double entry bookkeeping," it is suggested that the single word "bookkeeping" be used to describe the work it implies.

Sinking Fund: Investments, cash, etc. specially earmarked for the extinguishment of a debt, the redemption of preferred stock, or other purposes where it is necessary to provide funds over a period of years. It is often used in connection with bond issues, the trust deed providing that a constant or minimum annual amount be placed in the hands of a trustee, invested by him, such annual amount being so calculated that its accumulations with interest

will be sufficient to pay off the bonds at maturity. Such bonds are known as "Sinking fund bonds." This principle is sometimes applied to provisions for depreciation (see "Depreciation Methods"), but the term itself implies the actual setting aside of cash and investments intended to accumulate at interest.

Sinking Fund Reserve: A reserve appropriated from earned surplus from year to year to equal the increasing amount of a sinking fund, thus setting aside such appropriations and making them unavailable for purposes of dividends. When the sinking fund is matured and the liabilities for which it is raised are discharged, the sinking fund reserve becomes part of the general reserve of the company.

Sound Value: Present value of plant or other property as determined by appraisal; replacement cost less observed depreciation.

Special Audit: An investigation (q.v.).

Spread: (a) A term used to denote certain differences in market prices or grades of certain commodities. It is more or less a colloquialism, but has its particular usefulness as an expressive term which is well understood. Thus, it may be used to represent the difference during a stated period between the highest and lowest quoted prices of stocks; it is used in connection with the daily range of prices of the different grades of wheat, etc.

(b) A term sometimes used to mean the entering up or posting of a ledger, or of recording transactions, as "to spread on the records."

Staff Auditor: An internal auditor (see "Internal Audit").

Statement: Something which is said or written. In accounting, it refers to a condensed copy of an account, e.g., the monthly "statement" sent to a customer of his transactions. The word also applies to the condensed "statements" of Profit & Loss and Surplus Accounts, etc., made up at the end of the financial year of a business, and may also be applied to the balance sheet itself, which is really a condensation in classified form of the "Balance Account" of theoretical bookkeeping, now obsolete (see "Balance Sheet"). The word should be distinguished from "Schedule" (q.v.), which denotes a list.

Statement of Affairs: A statement drawn up in the form of a balance sheet, but either not made up from double entry, books, or if so made up, without regard to book figures and with consideration only for realizable values and expected claims, to show the net worth or deficiency of a business, and the relative liquidity of the business and priority of creditors' claims. Usually prepared for a business financially embarrassed, or actually in bankruptcy.

Stock: The capital of a company divided into shares. In Great Britain, however, there is a differentiation between "shares" and "stock." Shares may be converted into stock under certain conditions, and then the capital may be said to be in one "mass" (Lindley, "Companies") and each holder has a certain portion of the whole; theoretically transferable in any amount, although by-laws usually limit transfers to multiples of £1.

Stockholder: Shareholder.

Stock in Trade: The merchandise or products of a business on hand for the purpose of sale. It does not include supplies or repair parts used within the business which do not enter into finished products for sale, but does include raw materials and other supplies which form part of the manufactured products.

Stocks: Shares in companies. Hence, stockbroker—one who deals in shares and stocks on a brokerage basis.

Stores: Materials kept by a manufacturing or other institution used for the upkeep of plant, e.g., repair parts, oil, grease, etc.

Subsidiary Company: One in which the whole or a large proportion of its capital is held by another company called the parent company or "Holding Company" (q.v.).

Supplies: Any goods or materials on hand ready for use as such either in manufacture or for the upkeep of plant.

Surety: One who makes himself responsible for the act or default of another.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

The Special Committee on Auditing Procedure appointed by the American Institute of Accountants observed in their report, reproduced in this journal in June last (p. 435), that so many corporations closed their books upon a calendar year basis that the committee doubted whether the profession as at present organized could undertake to make physical test-checks adequately and satisfactorily on the last day of each year. More recently a special committee of the New York Stock Exchange,1 concerned with the audit of listed companies, made four recommendations as to corporate procedures which might in particular cases, enhance the effectiveness of the audit. One of these four recommendations was for the adoption of the natural business year in place of the calendar year. The committee pointed out that the adoption of the natural business year in each industry would help to smooth out the huge peaks of audit work which now occur in the early part of each calendar year, that it would simplify for corporations their problems of year-end adjustment and stocktaking, that it would permit a more efficient and more economical audit, and that by basing income reports on a completed cycle of a normal year's operations it would give the investor a fairer picture of the operations of his company. These advantages have long been urged by accountants in support of what they regard as an urgent reform—but without impressive result. Perhaps now that the reform is pressed by so influential a body as the New York Stock Exchange its pace will accelerate.

Of the three other suggestions of this special committee of the New York Stock Exchange whereby corporations, through control of their procedures, might improve audit effectiveness only one would seem to be relevant to Canadian conditions, namely, the suggestion that the responsibility, authority and facilities of the Controller or internal

¹New York Stock Exchange, Report of Sub-Committee on Independent Audits and Audit Procedure of Committee on Stock List, August 11, 1939.

auditor should be increased. The controller's duties, it was said, should be fixed by the Board of Directors, the controller should report periodically to the Board in addition to making his customary reports to the operating management, and the Board should take an active interest in the selection of the controller.

A correspondent with long and varied experience in the reading of examinations tells us that he was on one occasion challenged thus by a candidate: "It should be remembered by the examiner that in actual practice very few C.A.'s know the different Acts off by heart. The main idea is to have them at hand and to know where to look for the information when it is required." Our correspondent did not divulge whether he gave as much credit for wisdom as he would have done for knowledge.

STUDENT ASSOCIATION NOTES

ALBERTA

The Secretary of the Institute has sent word that the following are now engaged in activities arising out of the participation of Canada in the War:

Claude R. J. Parsons holds the rank of Lieutenant in the 20th Field Battery R.C.A., C.A.S.F. Mr. Parsons held this same rank in the 39th Battery R.C.A. and was drafted into the 20th Battery upon mobilization of that unit on 1st September 1939.

Lieutenant C. N. Mawer, a Calgary student, has left for Esquimalt to take up duties with the Navy. Lieutenant Mawer has served four years with the firm of Eric Richardson & Graves. At 21 years of age Lieutenant Mawer is one of the youngest officers in the Canadian Navy. At present he is serving as gunnery officer on a mine sweeper operating on the west coast.

Immediately upon the outbreak of war, Mr. D. W. Lowe, who held a Sub-Lieutenant's commission with the Royal Canadian Naval Volunteer Reserve, volunteered for active service and is now serving with the Canadian Navy at Esquimalt, B.C.

At the outbreak of war, Mr. M. K. Reed was with the 15th Light Horse and has since received a commission as Intelligence Officer in the Calgary Highlanders with the rank of Lieutenant.

BRITISH COLUMBIA

The first Council Meeting of the Students' Society was held on 24th October last, business on hand being the election of officers for the year 1939-1940. The results were as follows:

President: J. A. McIntyre Vice-President: A. H. Affleck Honorary Secretary-Treasurer: R. D. Young.

Following the election of officers, student activities for the coming year were discussed. Some promising suggestions were heard, and a full programme of events is looked for after the December examinations.

A number of students attended the informal discussion and dinner held in October by the Institute of Chartered Accountants of British Columbia. The main subject for discussion was the controversial "Valuation of Inventories." Mr. G. B. McCann of New York, who was present, gave an interesting outline of the new procedure being followed in the United States.

The value of these Institute dinner meetings to the senior students is considerable, both socially and educationally. We hope that our senior members will take full advantage of their privilege in the coming series of meetings.

Members of the fifth year Instruction Course were recently favoured with a brief address by a member of the Vancouver Junior Board of Trade on the advantages accruing to members of that body. He issued an invitation to students to investigate these benefits, stressing particularly the point that future members of the profession should not neglect the study of civic affairs.

MANITOBA

The Chartered Accountants Students' Society of Manitoba commenced its activities for the 1939-40 season with an annual general meeting on September 8th, at which the following Council was elected:

President: G. Earl
Vice-President: D. O'Brien
Secretary-Treasurer: G. M. Steele

DECEMBER, 1939.

Senior U.M.S.U. Rep.: G. M. Steele Junior U.M.S.U. Rep.: N. Wildgoose

Other Members: J. Barker, B. Davis, J. T.

Ellis, J. Iverach, D. Lavender, A. V. Neil, J. B. Prosser, M.

Reid, E. Rankin.

Subsequent discussion at the meeting included a survey by Mr. F. Johnson, member of the newly created board of Examiners-in-Chief for Canada, of the new system of Uniform Examinations for the Provincial Institutes, and the changes necessitated in the present schedule of lectures in order to conform with the change in examination dates from April to December. Provision was made to eliminate inequities arising from this change in respect to the requisite period of articleship and eligibility for writing examinations.

The activities of the Council were early directed to preparations for the annual banquet to be held in November. The services of President Sydney Smith, of the University of Manitoba, were secured for guest speaker, and entertainment, following last year's precedent, is to be provided by the students themselves. The usual fine success of this function is anticipated for this year.

Another matter of note in Council activities was the successful negotiation with the Institute of Chartered Accountants whereby every registered student of the current year is to be supplied free of charge with one year's subscription to The Canadian Chartered Accountant, the cost to be borne jointly by the two bodies.

QUEBEC

The Secretary of the Society has sent word that the following are now engaged in activities arising out of the participation of Canada in the War:

John Carswell has joined the First Corps Signals.

Captain George E. Starke is on active service with Victoria Rifles of Canada "B" Company.

Lieutenant R. S. Davidson has been appointed Paymaster, 17th Duke of York Royal Canadian Hussars Regiment.

PROBLEMS AND SOLUTIONS

The solution to the first problem below was prepared by the Editor of the Students' Department, that to the second problem by a practising chartered accountant of the Manitoba Institute. In each case the solution represents the views and opinions of the person who prepared it. Solutions are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

INTERMEDIATE EXAMINATIONS, MAY 1939

BOOKKEEPING AND ACCOUNTS (Including Executorship)

Question 3

FG, a tradesman, instructs you to prepare a Profit and Loss Account for the year ended December 31st, 1938 and a Balance Sheet as on that date.

The only book he has kept is a rough record of credit sales and a memorandum of cash drawings and expenses paid in cash.

All his takings have been banked except amounts retained for personal drawings and cash expenses which his notes shew to have been £200 and £250 respectively.

The amounts owing to him for credit sales at January 1st 1938 were ascertained to be £78. There were no records of Stock or Liabilities at that date, but he was of opinion that the Trade Creditors were about the same as at the end of the year.

There was nothing due for expenses at January 1st, 1938.

£300 had been spent on business premises and fittings prior to January 1st, 1938.

All his purchases of goods for resale were paid for by cheque and he informs you that all sales were at a price which would shew a uniform profit of 25 per cent. on selling price.

He had taken goods from stock for private consumption, the estimated cost of which was £150.

The Bank Pass Book shewed a balance at January 1st of £70, lodgments during the year £6,600 and withdrawals £6,480.

Included in the lodgments was £900, the proceeds of investments realised and brought into the business at that figure, and the withdrawals included £1,200 expended on the business premises and £350 for business expenses.

The following further information is supplied:-

	The state of the s	
Assets at	December 31st, 1938:—	£
Book	Debts	168
Stock	at cost	1,300
Liabilities	at December 31st, 1938:-	
Trade	Creditors for Goods	300
Credit	ors for Expenses and accruals	90

THE CANADIAN CHARTERED ACCOUNTANT

You are required to construct from the foregoing information:— Cash Account,

Sales and Purchases Accounts,

Profit and Loss Account,

Balance Sheets at December 31st, 1937 and 1938.

SOLUTION

CASH ACCOUNT

1938	1938
Jan. 1 Balance at Bank£ 70	Dec. 31 Personal drawings.£ 200
Dec. 31 Received from customers:	" 31 Expenses paid in cash 250
Deposited £5,700* Retained 450 6,150	" 31 Payments for mer- chandise 4,930
	" 31 Business premises. 1,200†
" 31 Sale of investments 900*	" 31 Expenses paid by cheque 350
	" 31 Balance 190
£7,120	£7,120
1938	
Dec. 31 Balance£ 190	
(Note: * indicates bank deposits	; † indicates bank withdrawals.)

SALES ACCOUNT

1938 Jan. 1 Book debts £ 78 Dec. 31 Sales for year 6,240	1938 Dec. 31 Cash received£6,150 " 31 Book debts 168
£6,318	£6,318

PURCHASES ACCOUNT

1938							1938						
Dec.	31	Cash	paid		£	4,930	Jan.	1	Trade	cre	ditor	s	300
44	31	Trade	cre	ditors		300	Dec.	31	Purcha	ases	for	year	4,930
					£	5,230						5	£5,230

STUDENTS' DEPARTMENT

FG

Profit and Loss Account for Year Ending December 31, 1938.

Stock Jan. 1, 1938		Sales			£6,240
Less: Stock Dec. 31, 1938	6,130 1,300				
Less: Withdrawals	4,830 150				
Cost of Sales					
-	E6,240				£6,240
Expenses		Gross	trading	profit	£1,560
4	21,560				£1,560

(Note: The figure of stock at January 1, 1938 is deduced by working backward from the gross trading profit which is computed as 25/100 of £6,240).

FG

Balance Sheet as at December 31, 1937.

Balance in bank £ 70 Book debts 78 Stock 1,200 Investments 900 Business premises and fittings 300	Trade creditors (for Goods)
£2,548	£2,548

FG

Balance Sheet as at December 31, 1938.

Balance in bank .£ 190 Book debts .168 Stock	Trade creditors (for Goods) £ 300 Creditors for expenses and accruals
Business premises and fit- tings 1,500	Capital Balance Jan. 1£2,248 Profit
	3,128 Drawings 350 2,778
£3,158	£3,15

PROBLEM II

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF MANITOBA.

FINAL EXAMINATIONS, MAY 1939

ADVANCED ACCOUNTING-SECTION II

Questions 3 and 4

The Whizbang Munition Co., Ltd., have asked you to assist them in preparing tenders for two different types of shells—shrapnel and high explosive. You learn that the Company operated at 80% of normal capacity in 1938, and that its Profit and Loss Account for the year ended 31st December, 1938, was as follows:

Sales	\$1,000,000.00
Materials Used\$650,000.00	
Direct Wages 140,000.00	
Indirect Wages 28,000.00	
Supplies 15,000.00	
Taxes 6,000.00	
Power and Light 10,000.00	
Insurance 4,000.00	
Superintendence 7,000.00	
Depreciation—Buildings 5,000.00	
Depreciation—Plant	
Administrative Salaries and Expense 45,000.00	
Bad Debts 5,000.00	
Bond Interest 10,000.00	
Sales—Salaries	
Sales—Travelling Expense 8,000.00	
	970,000.00
Profit	\$ 30,000.00

You obtain the following additional information:

The number of men employed in direct manufacturing under normal conditions is one hundred.

	Shrapnel	High Explosive
Cost of steel		21/4c per lb.
Cost of other materials	3c per lb.	4 c per lb.
Weight of steel per shell10	00 lbs.	120 lbs.
Weight of other materials		
(powder, etc.) per shell	20 lbs.	30 lbs.
Loss of weight in manufacturing	5%	5%
Estimated spoilage at inspection	10%	10%
Number of machines	50	40
Rate of wages per hour	75c	80c
Number of shells completed per		
hour per man	1	11/4
Value of shell scrap is 4c per lb.		

Prepare in detail the price per shell you would advise your client to submit. Give reasons for any assumptions you may make.

STUDENTS' DEPARTMENT

4. The Whizbang Munition Company, Ltd., of the previous question obtains its raw materials from two subsidiaries; steel from Dud Steel Company Ltd., and other materials from Big Bertha Manufacturing Co. Ltd. At 31st December, 1938, the Whizbang Company has on hand the following raw materials and finished shells:

S	Shrapnel	High Explosive
Steel 20 Other materials 4 Shells completed 15	ons	15 tons 3 tons 11 tons, 230 lbs.
The cost of manufacturing per lb. is:		
Steel		2 cents 3½ cents
What is the amount of Inter-Cor	nnany profit c	contained in the

What is the amount of Inter-Company profit contained in the Whizbang Company inventory?

SOLUTION

3. This problem can be solved in several ways, depending on the assumptions which the student makes. The solution given must therefore be regarded as a solution, not the solution,

WHIZBANG MUNITION CO. LTD.

TENDER FOR SHELLS

		Shrapnel	H.E.
Steel			\$ 2.70
Other Materials			1.20
Direct Wages		.75	.64
Indirect Wages)			
Supplies) (1)		28	.24
Power and Light)			
Taxes)			
Insurance) (2)		.07	.06
Superintendence)			
Depreciation (3)		.13	.10
Add: Allowance for spoilage 1/9		\$ 3.83 .43	\$ 4.94 .55
Less: Steel Scrap 14.5% of 100 lbs. @ 1/4c per	116	\$ 4.26	\$ 5.49
14.5% of 120 lbs. @ 4c per			.04
		\$ 4.23	\$ 5.45
Adminstrative Salaries and Expense)			
Bond Interest) (4)		.30	.26
Sales Salaries)			
Sales Travelling Expense)			
		\$ 4.53	\$ 5.71
Profit on 1938 basis 3% on Selling Price		.14	.18
		\$ 4.67	\$ 5.89

THE CANADIAN CHARTERED ACCOUNTANT

- (1) These items vary with production. In 1938 they were 38% of direct wages and it is assumed that they will increase pro-rata in 1939, although admittedly this actually may not be the case.
- (2) These items do not vary with production. In 1938 they were 10% of normal direct wages of \$172,000.00.
- (3) It is assumed that all machines are of equal value; also that each is in use 2,300 hours per annum (44 hours x 52 weeks) and occupies space according to number.

Shrapnel
$$\frac{60}{100}$$
 of \$30,000.00 = \$18,000.00

High Explosive
$$\frac{40}{100}$$
 of \$30,000. = \$12,000.00

Depreciation per shell is \$18,000. \div 2,300 shells x 60 machines = \$138,000.

Depreciation per shell is \$12,000. \div 2,875 shells x 40 machines = \$115,000.

(4) Assumed that these will not fluctuate with production; also that there will be no bad debts and that sales travelling expense will decrease. Say the total for 1939 is \$70,000.00 which is 40% of normal direct wages.

INTER-COMPANY PROFIT

4.

	S	SHRAPNEL		HIGH EXPLOSIVE	
(1)	Cost Pare Co	sidiary .00 \$700.00 .00 200.00	Cost to Parent Co. \$675.00 240.00 468.00	Cost to Sub- sidiary \$600.00 210.00 416.00	70.00
\- /	(" Other Materials 180	.00 150.00	208.00	182.00	56.00
					\$428.00

- (1) 15 tons 780 lbs, represents 85.5% or original weight purchased (100 5% loss in manufacturing 10% spoilage).
 - . '. original weight on the basis of 5 lbs, steel to 1 lb, other materials is

 Steel
 30,000 lbs.

 Other materials
 6,000 lbs.

Original weight of 11 tons 230 lbs. on the basis of 4 lbs. steel to





